ORIGINAL NEW APPLICATION

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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF QWEST CORPORATION d/b/a CENTURYLINK-QC FOR APPROVAL TO CHANGE THE ACCOUNTING METHODOLOGY USED TO REPORT FOUR ACCOUNTING ISSUES TO THE ARIZONA CORPORATION COMMISSION

DOCKET NO. T-01051B-12-0431

APPLICATION FOR APPROVAL TO CHANGE ACCOUNTING METHODOLOGY

1. Qwest Corporation d/b/a CenturyLink-QC ("CenturyLink") respectfully requests approval to change the accounting method used for four accounting issues reported to the Arizona Corporation Commission ("Commission"). The accounting method for the four accounting issues are special exceptions to CenturyLink's normal accounting basis. The four exceptional issues cause CenturyLink considerable effort, because they must be accounted for manually. The accounting for these four issues and the method by which they are accounted, are only relevant for cost of service rate setting. The Commission has determined that cost of service rate setting is no longer needed, in view of the Commission's decision that CenturyLink's services are competitive.[1] Accordingly, specialized ratemaking accounting treatment for the four issues no longer serves any purpose, and may be

1 *In the Matter of the Application of Qwest Corporation D/B/A CenturyLink-QC ("CenturyLink")To Classify and Regulate Retail Local Exchange Telecommunications Services As Competitive, and To Classify and Deregulate Certain Services As Non-Essential*, Arizona Corporation Commission Decision No. 73354, Docket No. T-01051B-11-0378, August 21, 2012 ("*Competitive Classification Decision*").

discontinued without harm to the public interest.

2. The four accounting issues—known as "Jurisdictional Differences" or "JDs"— for which CenturyLink asks to discontinue specialized ratemaking accounting, are:

Flow-through of unprotected excess deferred taxes;
Depreciation rate differences;
Depreciation amortization differences; and
AFUDC after 9/1/1995.

For the reasons discussed below, CenturyLink heretofore has applied Arizona ratemaking treatment to its accounting for these four JDs on an intrastate basis. Because the accounting for Arizona ratemaking is unique to the State's jurisdiction, the accounting basis is referred to by CenturyLink as "jurisdictional" or "JR" accounting.

3. CenturyLink asks for approval to discontinue Arizona JR accounting for these four issues and to use the same accounting it uses for the federal regulatory jurisdiction and for all other states' regulatory accounting and reporting (referred to by CenturyLink as Monthly Reporting, or "MR" accounting). CenturyLink asks that the change become effective as of January 1, 2012. CenturyLink currently reports all other accounting matters to the Commission on the MR accounting basis. Thus, this Application seeks approval to use MR accounting for all of Qwest's accounting and reporting in Arizona.

4. If the Commission approves CenturyLink's request to discontinue JR accounting for the four JDs and to use MR accounting for all issues, Centurylink will be in compliance with the Commission's rules which require that telephone companies in Arizona keep their accounting books and records in conformity to the current FCC requirements for accounting. (*A.A.C. R14-2-510.G*).

5. The JDs all originated during the course of cost-of-service ratemaking dockets and have been carried forward in every cost-of-service rate setting proceeding occurring

subsequent to their first emergence. An explanation of the origin of the four JDs is attached to this Application, marked as Attachment A.

6. The Commission recently ruled in its *Competitive Classification Decision*[2] that CenturyLink's services are competitive under A.C.C. R14-1108 subject to conditions. As a competitive provider, CenturyLink is authorized to file for rate changes under streamlined rate-setting procedures. Specifically, the Commission's order provides, "CenturyLink shall not hereafter be required to make a rate case filing under Rule 103, unless the Commission makes a finding that CenturyLink's services are not competitive." Since the JR Issues arise out of full cost-of -service ratemaking proceedings filed under Rule 103, and are only relevant to full cost of service proceedings, and since CenturyLink is specifically relieved of the requirement to make rate case filings, it is pointless to maintain the specialized JR accounting. CenturyLink should be relieved of the burden to do so.

7. In addition, CenturyLink's Arizona annual report to the Commission contains several schedules reported on the JR accounting basis. Specifically, the following five schedules were reported on the Arizona JR accounting basis:

Annual Report Page Number	Schedule	Source
4	Net Telephone Plant in Service	JR1 report
4	Revenue	JR basis Summary 1990s report
4	Net Operating Income	JR basis Summary 1990s report
8	Income Statement, Balance Sheet	JR1 report
NA	Rate Case Adjusted Results	JR basis Summary 1990s report

If the Commission grants the change requested herein, CenturyLink will continue to file these categories of schedules with its annual report. However, instead of filing them using JR accounting, CenturyLink will file them using MR accounting.

2 *See*, fn. 1, *supra.*

8. CenturyLink's accounting systems cannot perform the JR accounting on an automated basis. While the accounting system is capable of calculating JDs on a total state basis, intrastate JDs of the type maintained historically would have to be calculated manually. Additionally, there is no accepted methodology to calculate on a total state basis JDs that have always been maintained on an intrastate basis. Maintaining JDs requires accounting resources for a work product that has no ongoing utility to the Company or to the Commission in view of the Competitive Classification Decision. Consequently, CenturyLink aims to end JR accounting in Arizona, effective as of the end of 2011 and to use MR accounting exclusively for all purposes effective January 1, 2012. Discontinuing JR accounting at year-end 2011 is preferable to discontinuing it mid-year 2012 because year-end 2011 discontinuance allows results of operations for all of calendar year 2012 to be reported on a single, consistent basis of accounting, i.e., the MR accounting basis.

9. As stated above, the *Competitive Classification Decision* relieved CenturyLink from the obligation to make Rule 103 rate case filings, unless the Commission makes a finding that CenturyLink's services are not competitive. In some states, regulatory commissions granted Qwest permission to discontinue JR accounting without condition. In other states, permission was granted subject to the condition that Qwest compute a *standing rate base adjustment*. A standing rate base adjustment is an adjustment to rate base in a cost-of-service determination that equals the difference between the rate base computed on the original basis of accounting (in this case the JR basis) and the rate base computed on a new basis of accounting (in this case the MR basis) on the date the utility changes from using the original basis (JR) to the new basis (MR).

10. The purpose of a standing rate base adjustment is to capture the difference in the rate base under the JR and MR bases of accounting on the date of conversion from JR to

MR, so that this difference can be preserved, in the event it is determined to be relevant in any future cost-of-service ratemaking determinations.

11. The value of a standing rate base adjustment for Arizona as of December 31, 2011 is **negative** $369,050,660. In a cost-of-service determination in Arizona that relies on the MR basis of accounting, this standing rate base adjustment reduces CenturyLink's intrastate Arizona rate base computed on the MR basis by $369,050,660.

12. CenturyLink brings up the standing rate base adjustment only for the purpose of identifying the amount that is attributable to the difference between JR and MR accounting if it were considered relevant in the unlikely event of a future cost of service ratemaking determination. CenturyLink does not propose that a Commission decision approving this Application should decree that an adjustment to rate base must be made in any future cost-of-service rate determination. Whether the standing rate base adjustment set forth above should be incorporated into the MR basis rate base in a future ratemaking determination, should be determined in the course of such a proceeding.

13. The Commission's authority to approve this application arises under A.R.S. 40-221 and 40-222, which authorizes the Commission to prescribe the system of accounts kept by public service corporations.

14. The *Competitive Classification Decision* expressly relieved CenturyLink from filing rate cases under Rule 103. By that decision, the Commission implicitly relieved CenturyLink from the specialized and unique cost-of-service ratemaking accounting methodologies that had built up over decades of dockets. To the extent necessary, CenturyLink respectfully requests that the Commission grant a waiver of previous orders that may be inconsistent with the accounting changes sought herein.

15. For the reasons stated above, CenturyLink respectfully requests that pursuant to A.R.S. 40-221 and 40-222, the Commission approve CenturyLink's use of the MR accounting basis for all accounting and reporting purposes in Arizona effective January 1, 2012, without prejudice to the question of whether the rate base adjustment identified shall be applied in a future ratemaking determination.

Respectfully submitted, this 3rd day of October, 2012

QWEST CORPORATION d/b/a
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ATTACHMENT A

EXPLANATION OF THE ORIGIN OF THE FOUR JURISDICTIONAL DIFFERENCES (JDSs)

Prepared by Philip Grate, CenturyLink Director of Regulatory Finance

FLOW-THRU OF UNPROTECTED EXCESS DEFERRED TAXES

In Decision No. 56009, Docket No. E-1051-88-034 (June 13, 1988), the ACC ordered the Mountain States Telephone and Telegraph Company (the predecessor of Qwest Corporation in Arizona) to issue a refund to ratepayers equal to $4.26 million to flow through to Arizona ratepayers unprotected excess deferred taxes. The $4.26 million was the product of multiplying $2,600,000 of net unprotected excess deferred taxes as of December 31, 1987 by a revenue multiplier of 1.6410.[1] Qwest recorded the $2,600,000 flow-through as a net deferred charge to account 4340 on its Arizona jurisdictional books in June of 1988. The FCC never ordered flow through of unprotected excess deferred taxes. Accordingly, Qwest Corporation is amortizing the deferred charge resulting from the difference in accounting between the Arizona ACC and the FCC on its Arizona jurisdictional books over 28 years. The amortization is $7,738.00 per month and is scheduled to end December 31, 2017.

DEPRECIATION RATE DIFFERENCES

Several states required Qwest to accrue depreciation expense at different rates than those established by the FCC. The ACC issued depreciation orders in 1991 (ACC Dockets No. E-1051-91-145 and E-1051-90-067, Decision No. 57462) and 2000 (ACC Docket No. T-01051B-97-0689, Decision No. 62507). The last ACC order prescribing depreciation rates for Qwest was in 2006 in the docket that renewed Qwest's Arizona Price Plan.[2] In that docket, Qwest entered into a Settlement Agreement with ACC Staff and several other parties. Among other things, the Settlement Agreement provided that Qwest would use certain depreciation rates and employ a five year amortization as set forth on a separate schedule appended to the Settlement Agreement.

DEPRECIATION AMORTIZATION DIFFERENCES

In the docket that renewed Qwest's Arizona Price Plan[3] Qwest entered into a Settlement Agreement with ACC Staff and several other parties. Among other things, the Settlement Agreement provided that Qwest would use certain depreciation rates and employ a five year amortization as set forth on a separate schedule appended to the Settlement Agreement. The Settlement Agreement also provided that the new rates and five year amortization would

1 Arizona Docket No. E-1051-88-034, Mountain Bell - Exhibit 1, Page 3 – C.A. Phillips, April 15, 1988.
2 Arizona Corporation Commission Decision No. 68604, March 23, 2006. Docket No. T-01051B-03-0454.
3 Arizona Corporation Commission Decision No. 68604, March 23, 2006. Docket No. T-0151B-03-0454.

commence effective on the first day of the month following the date of the ACC's order adopting the Settlement Agreement. The ACC docketed its order March 23, 2006. Consequently, the five year amortization commenced April 1, 2006.

AFUDC AFTER 9/1/95

The FCC's accounting rules for telephone companies require all costs associated with acquiring and readying an asset for its intended use to be capitalized as part of the asset's cost.[4] One of these costs is the cost of financing the investment in the asset during the construction period. The cost is referred to as the Allowance for Funds Used During Construction (AFUDC). The FCC's rules (CFR Title 47, Parts 32 and 65) specify the accounting and interstate regulatory treatment of AFUDC.

In general, there are three ways to compensate carriers for their investments in assets (TPUC) during the construction period:

> **Capitalization Method**. Under this method, TPUC is excluded from the rate base during the construction period but carriers are allowed to capitalize the interest cost, i.e., AFUDC, during that same time period. When plant is placed into service, the cost of construction, including the capitalized AFUDC is transferred from TPUC to TPIS (telephone plant in service) and included in the rate base. Carriers are permitted to earn a rate of return on the new plant, including the AFUDC, and the cost of that plant is recovered through depreciation expense over the useful life of the plant.
>
> **Rate Base Method**. Under this method, TPUC is included in the rate base during the construction period and the interest is treated as an expense during the same period.
>
> **Revenue Requirement Offset Method**. Under this method, TPUC is included in the rate base during the construction period and AFUDC is recognized as a part of that construction cost. To prevent double recovery, the AFUDC for the current period is treated as a revenue amount for ratemaking purposes, thus reducing the cost of service carrier's revenue requirement.

The method prescribed by the FCC has varied over time. In 1967 the FCC required AT&T and the Bell System companies (which included Qwest's predecessor in Arizona) to use the Revenue Requirement Offset Method for ratemaking.[5]

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4 Section 32.2000(c)of the FCC's accounting rules (CFR Title 47, Part 32) requires telephone companies to charge to the telecommunications plant accounts, where applicable, all direct and indirect costs in accounting for construction costs.

5 FCC Docket No. 16258, American Telephone and Telegraph Co., *Interim Decision and Order*, 9 FCC 2d at 41-42, recon., 9 FCC 2d at 971-972.

In 1977, the FCC prescribed that carriers use the Capitalization Method for long term construction projects. At the same time, the FCC directed carriers to impute interest at the prime interest rate in determining AFUDC. Concurrently, the FCC directed that carriers use the Rate Base Method for short term projects (those under construction less than one year).[6]

In 1995, the FCC adopted the revenue requirement offset method for both long-term and short-term construction projects. [7] The FCC's order explains that the revenue requirement offset method is the best approach. First, it complies with GAAP for both short-term and long-term construction projects. Second, it gives carriers an incentive to invest in new plant because both short-term and long-term plant under construction and the capitalized AFUDC are included in rate base and, as a result, carriers are allowed to earn a rate of return on the total investment. Third, including the amount of AFUDC capitalized in both the rate base and current income has the effect of mitigating the increase in revenue requirement that results from including all TPUC in the rate base. Fourth, the other two methods lack all of these advantages.[8]

The interest rate used for FCC accounting of AFUDC is the company's Average Cost of Debt.[9]

In Arizona, the methods used to account for AFUDC have also varied over the decades. Prior to 1982, the Company employed the capitalization method for short-term plant construction projects (STPUC).[10] In the 1983 and 1986 rate case decisions[11] the ACC relied on the rate base method for calculating the Company's STPUC. In the Company's 1993 rate case, the Company's revenue requirement used the rate base method for STPUC but the Staff recommended[12] and the ACC adopted the Capitalization method.

For Arizona JR accounting purpose, Qwest employs the capitalization method of accounting for short-term plant under construction (STPUC) using the cost of capital last found by the ACC[13] and long-term plant under construction (LTPUC) using the Prime Interest Rate.[14]

6 The revenue requirement offset method was adopted by American Telephone and Telegraph Co., Docket No. 19129, *Interim Decision and Order*, 9 FCC 2d 30, 41-42, recon., 9 FCC 2d 960, 971-972 (1967); and the capitalization and rate base methods were adopted in *Phase II Final Decision and Order* 64 FCC 2d at 59.

7 Report and Order FCC 95-56, CC Docket 93-50, released February 28, 1995

8 *Id.*, ¶10.

9 47 CFR 32.2000(c)(2)(x).

10 A.C.C Docket No. 9981-E-1051-81-406, Decision 53040 (May 21, 1982 Order paragraph 4, page 5. See also Stipulation to Form of Order pages 5 and 6.

11 A.C.C Docket No. E1051-83-035, Decision No. 53849 (December 22, 1983) page 21 and A.C.C. Docket No. E-1081-84-100, Decision No. 54843 (January 10, 1986), page 28

12 A.C.C. Docket No. E-1051-93-183, Decision No. 58927 (January 3, 1995) pages 5-6.

13 A.C.C. Docket No. E-1051-93-183, Decision No. 58927 (January 3, 1995) page 130.

14 AFUDC is assigned to LTPUC consistent with the FCC's TPUC rules (fn 10, above) since A.C.C. decisions have only addressed STPUC.